

plan and on whether the plan determines benefits based on average compensation. For this purpose, average entry age equals the average attained age of all employees in the plan, minus the average years of participation of all employees in the plan. A plan is treated as determining benefits based on average compensation if it determines benefits based on compensation averaged over a specified period not exceeding five consecutive years (or the employee's entire period of employment with the employer, if shorter).

TABLE OF FACTORS

Average entry age	Factors	
	Average compensation benefit formula	Other formulas
Less than 30	0.5	0.75
30 to 40	0.4	0.6
Over 40	0.2	0.3

(v) *Examples.* The following examples illustrate the rules of this paragraph (b)(2):

Example 1. Plan A is a contributory DB plan that is a defined benefit excess plan providing a benefit equal to 2.0 percent of employees' average annual compensation at or below covered compensation, plus 2.5 percent of average annual compensation above covered compensation, times years of service up to 35. Under the plan, average annual compensation is determined using a five-consecutive-year period for purposes of § 1.401(a)(4)-3(e)(2). The plan requires employee contributions at a rate of four percent of plan year compensation for all employees. Assume that the plan satisfies the demographic requirements of paragraph (b)(2)(ii)(B) of this section. Under these facts, the plan satisfies the eligibility requirements of paragraph (b)(2)(ii) of this section. Assume, further, that the average attained age for all employees in the plan is 55, and that the average years of participation of all employees in the plan is 10. The average entry age for the plan is therefore 45, and, accordingly, the appropriate factor under the table is 0.2. Thus, in applying the safe harbor requirements of § 1.401(a)(4)-3(b) to this plan for the plan year (including the requirements of § 1.401(l)-3), the employee's base benefit percentage and excess benefit percentage are each reduced by 0.8 percent (4 percent × 0.2) and equal 1.2 percent and 1.7 percent, respectively.

Example 2. The facts are the same as in *Example 1*, except that the employee contribu-

tion rate is two percent of plan year compensation up to the covered compensation level, and four percent for plan year compensation at or above that contribution breakpoint. The employer elects to apply the alternative method in paragraph (b)(2)(iii)(B)(2) of this section to determine the reduction in the base benefit percentage. Because the contribution breakpoint is equal to the integration level, the weight of the employee contribution rate below the contribution breakpoint is 100 percent, and the weight of the employee contribution rate above the contribution breakpoint is zero. Thus, the weighted average of employee contribution rates is two percent. Under the alternative method in paragraph (b)(2)(iii)(B)(2) of this section, the reduction in the employee's base benefit percentage is 0.4. In applying the safe harbor requirements of § 1.401(a)(4)-3(b) to this plan (including the requirements of § 1.401(l)-3), the employee's base benefit percentage is 1.6 percent, and the employee's excess benefit percentage is 1.7.

Example 3. The facts are the same as in *Example 1*, except that the employee contribution rate is two percent of plan year compensation up to 50 percent of the covered compensation level, and four percent for plan year compensation at or above that contribution breakpoint. Because the contribution breakpoint is equal to 50 percent of the integration level, the weight of the employee contribution rate below the contribution breakpoint is 50 percent, and the weight of the employee contribution rate above the contribution breakpoint is 50 percent. Thus, the weighted average of employee contribution rates is three percent. Under the alternative method in paragraph (b)(2)(iii)(B)(2) of this section, the reduction in the employee's base benefit percentage is 0.6. In applying the safe harbor requirements of § 1.401(a)(4)-3(b) to this plan (including the requirements of § 1.401(l)-3), the employee's base benefit percentage is 1.4 percent, and the employee's excess benefit percentage is 1.7.

Example 4. The facts are the same as in *Example 1*, except that the plan is tested using the general test in § 1.401(a)(4)-3(c). Assume Employee M benefits under Plan A and has a normal accrual rate for the plan year (calculated with respect to Employee M's total accrued benefit) of 2.2 percent of average annual compensation. In applying the general test in § 1.401(a)(4)-3(c) with respect to employer-provided benefits, this rate is reduced by 0.8 to yield a normal accrual rate of 1.4 percent. This rate may then be adjusted using either of the optional rules in § 1.401(a)(4)-3(d)(3)(i) or (ii).

(3) *Minimum-benefit method*—(i) *Application of uniform factors.* A contributory DB plan that satisfies the uniform rate requirement of paragraph (b)(2)(ii)(A)

of this section and the minimum benefit requirement of paragraph (b)(3)(ii) of this section may apply the adjustments provided in paragraph (b)(2)(iii) of this section as if the average entry age of employees in the plan were within the range of 30 to 40, without regard to the actual demographics of the employees in the plan.

(ii) *Minimum benefit requirement.* This requirement is satisfied if the plan provides that, in plan years beginning on or after the effective date of these regulations, as set forth in § 1.401(a)(4)-13(a) and (b), each employee will accrue a benefit that equals or exceeds the sum of—

(A) The accrued benefit derived from employee contributions made for plan years beginning on or after the effective date of these regulations, determined in accordance with section 411(c); and

(B) Fifty percent of the total benefit accrued in plan years beginning on or after the effective date of these regulations, as determined under the plan benefit formula without regard to that portion of the formula designed to satisfy the minimum benefit requirement of this paragraph (b)(3)(ii).

(iii) *Example.* The following example illustrates the minimum-benefit method of this paragraph (b)(3):

Example. Plan A is contributory DB plan. For the plan year beginning in 1994, Employee M participates in Plan A and accrues a benefit under the terms of the plan (without regard to the minimum benefit requirement of paragraph (b)(3)(ii) of this section) of \$3,000. The portion of Employee M's benefit accrual for the plan year beginning in 1994 derived from employee contributions is \$2,000, determined by applying the rules of section 411(c) to such contributions. The requirement of paragraph (b)(3)(ii) of this section is not satisfied for the plan year beginning in 1994 unless the plan provides that Employee M's benefit accrual for the plan year beginning in 1994 is equal to \$3,500 (\$2,000+(50 percent×\$3,000)).

(4) *Grandfather rule for plans in existence on May 14, 1990.* A contributory DB plan that satisfies paragraph (c)(4) of this section may determine an employee's employer-provided benefit by subtracting from the employee's total benefit the employee-provided benefits determined using any reasonable method set forth in the plan, provided that it is

the same method used in determining whether the plan satisfies paragraph (c)(4)(ii)(D) of this section.

(5) *Government-plan method.* A contributory DB plan that is established and maintained for its employees by the government of any state or political subdivision or by any agency or instrumentality thereof may treat an employee's total benefit as entirely employer-provided.

(6) *Cessation of employee contributions.* If a contributory DB plan provides that no employee contributions may be made to the plan after the last day of the first plan year beginning on or after the effective date of these regulations, as set forth in § 1.401(a)(4)-13 (a) and (b), the plan may treat an employee's total benefit as entirely employer-provided.

(c) *Rules applicable in determining whether employee-provided benefits are nondiscriminatory in amount—*(1) *In general.* A contributory DB plan satisfies § 1.401(a)(4)-1(b)(2) with respect to the amount of employee-provided benefits for a plan year only if the plan satisfies the requirements of paragraph (c)(2), (c)(3), or (c)(4) of this section for the plan year. This requirement applies regardless of the method used to determine the amount of employer-provided benefits under paragraph (b) of this section.

(2) *Same rate of contributions.* This requirement is satisfied for a plan year if the employee contribution rate (within the meaning of paragraph (b)(2)(ii)(A) of this section) is the same for all employees for the plan year.

(3) *Total-benefits method.* This requirement is satisfied for a plan year if—

(i) The total benefits (i.e., the sum of employer-provided and employee-provided benefits) under the plan would satisfy § 1.401(a)(4)-3 if all benefits were treated as employer-provided benefits; and

(ii) The plan's contribution requirements satisfy paragraph (b)(2)(ii)(A) of this section.

(4) *Grandfather rules for plans in existence on May 14, 1990—*(i) *In general.* This requirement is satisfied for a plan year if the plan contained provisions as of May 14, 1990, that meet the requirements of paragraph (c)(4)(ii) or (c)(4)(iii) of this section.

(ii) *Graded contribution rates.* The plan's provisions meet the requirements of this paragraph (c)(4)(ii) if all the following requirements are met:

(A) The provisions require employee contributions at a greater rate (expressed as a percentage of compensation) at higher levels of compensation than at lower levels of compensation.

(B) The required rate of employee contributions is not increased after May 14, 1990, although the level of compensation at which employee contributions are required may be increased or decreased.

(C) All employees are permitted to make employee contributions under the plan at a uniform rate with respect to all compensation, beginning no later than the last day of the first plan year to which these regulations apply, as set forth in § 1.401(a)(4)-13 (a) and (b).

(D) The benefits provided on account of employee contributions at lower levels of compensation are comparable to those provided on account of employee contributions at higher levels of compensation.

(iii) *Prior year compensation.* The plan's provisions meet the requirements of this paragraph (c)(4)(iii) if they are part of a plan maintained by more than one employer that requires employee contributions and the rate of required employee contributions, expressed as a percentage of compensation for the last calendar year ending before the beginning of the plan year, is the same for all employees.

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§ 1.401(a)(4)-7 Imputation of permitted disparity.

(a) *Introduction.* In determining whether a plan satisfies section 401(a)(4) with respect to the amount of contributions or benefits, section 401(a)(5)(C) allows the disparities permitted under section 401(l) to be taken into account. For purposes of satisfying the safe harbors of §§ 1.401(a)(4)-2(b)(2) and 1.401(a)(4)-3(b), permitted disparity may be taken into account only by satisfying section 401(l) in form in accordance with § 1.401(l)-2 or 1.401(l)-3, respectively. For purposes of the general tests of §§ 1.401(a)(4)-2(c) and 1.401(a)(4)-3(c), permitted disparity may be taken into account only in ac-

cordance with the rules of this section. In general, this section allows permitted disparity to be arithmetically imputed with respect to employer-provided contributions or benefits by determining an adjusted allocation or accrual rate that appropriately accounts for the permitted disparity with respect to each employee. Paragraph (b) of this section provides rules for imputing permitted disparity with respect to employer-provided contributions by adjusting each employee's unadjusted allocation rate. Paragraph (c) of this section provides rules for imputing permitted disparity with respect to employer-provided benefits by adjusting each employee's unadjusted accrual rate. Paragraph (d) of this section provides rules of general application.

(b) *Adjusting allocation rates—(1) In general.* The rules in this paragraph (b) produce an adjusted allocation rate for each employee by determining the excess contribution percentage under the hypothetical formula that would yield the allocation actually received by the employee, if the plan took into account the full disparity permitted under section 401(l)(2) and used the taxable wage base as the integration level. This adjusted allocation rate is used to determine whether the amount of contributions under the plan satisfies the general test of § 1.401(a)(4)-2(c) and to apply the average benefit percentage test on the basis of contributions under § 1.410(b)-5(d). Paragraphs (b)(2) and (b)(3) of this section apply to employees whose plan year compensation does not exceed and does exceed, respectively, the taxable wage base, and paragraph (b)(4) of this section provides definitions.

(2) *Employees whose plan year compensation does not exceed taxable wage base.* If an employee's plan year compensation does not exceed the taxable wage base, the employee's adjusted allocation rate is the lesser of the A rate and the B rate determined under the formulas below, where the permitted disparity rate and the unadjusted allocation rate are determined under paragraph (b)(4) (ii) and (iv) of this section, respectively.

A Rate = $2 \times$ unadjusted allocation rate
 B Rate = unadjusted allocation rate + permitted disparity rate

§ 1.401(a)(4)-7

26 CFR Ch. I (4-1-03 Edition)

(3) *Employees whose plan year compensation exceeds taxable wage base.* If an employee's plan year compensation exceeds the taxable wage base, the employee's adjusted allocation rate is the lesser of the C rate and the D rate de-

termined under the formulas below, where allocations and the permitted disparity rate are determined under paragraph (b)(4) (i) and (ii) of this section, respectively.

$$\begin{aligned} \text{C Rate} &= \frac{\text{allocations}}{\text{plan year compensation} - \frac{1}{2} \text{ taxable wage base}} \\ \text{D Rate} &= \frac{\text{allocations} + (\text{permitted disparity rate} \times \text{taxable wage base})}{\text{plan year compensation}} \end{aligned}$$

(4) *Definitions.* In applying this paragraph (b), the following definitions govern—

(i) *Allocations.* Allocations means the amount determined by multiplying the employee's plan year compensation by the employee's unadjusted allocation rate.

(ii) *Permitted disparity rate—(A) General rule.* Permitted disparity rate means the rate in effect as of the beginning of the plan year under section 401(l)(2)(A)(ii) (e.g., 5.7 percent for plan years beginning in 1990).

(B) *Cumulative permitted disparity limit.* Notwithstanding paragraph (b)(4)(ii)(A) of this section, the permitted disparity rate is zero for an employee who has benefited under a defined benefit plan taken into account under § 1.401(l)-5(a)(3) for a plan year that begins on or after one year from the first day of the first plan year to which these regulations apply, as set forth in § 1.401(a)(4)-13 (a) and (b), if imputing permitted disparity would result in a cumulative disparity fraction for the employee, as defined in § 1.401(l)-5(c)(2), that exceeds 35. See § 1.401(l)-5(c)(1) for special rules for determining whether an employee has benefited under a defined benefit plan for this purpose.

(iii) *Taxable wage base.* Taxable wage base means the taxable wage base, as defined in § 1.401(l)-1(c)(32), in effect as of the beginning of the plan year.

(iv) *Unadjusted allocation rate.* Unadjusted allocation rate means the employee's allocation rate determined under § 1.401(a)(4)-2(c)(2)(i) for the plan

year (expressed as a percentage of plan year compensation), without imputing permitted disparity under this section.

(5) *Example.* The following example illustrates the rules in this paragraph (b):

Example. (a) Employees M and N participate in a defined contribution plan maintained by Employer X. Employee M has plan year compensation of \$30,000 in the 1990 plan year and has an unadjusted allocation rate of five percent. Employee N has plan year compensation of \$100,000 in the 1990 plan year and has an unadjusted allocation rate of eight percent. The taxable wage base in 1990 is \$51,300.

(b) Because Employee M's plan year compensation does not exceed the taxable wage base, Employee M's A rate is 10 percent (2×5 percent), and Employee M's B rate is 10.7 percent (5 percent+5.7 percent). Thus, Employee M's adjusted allocation rate is 10 percent, the lesser of the A rate and the B rate.

(c) Employee N's allocations are \$8,000 (8 percent×\$100,000). Because Employee N's plan year compensation exceeds the taxable wage base, Employee N's C rate is 10.76 percent (\$8,000 divided by (\$100,000 - (½×\$51,300))), and Employee N's D rate is 10.92 percent ((\$8,000 + (5.7 percent×\$51,300)) divided by \$100,000). Thus, Employee N's adjusted allocation rate is 10.76 percent, the lesser of the C rate and the D rate.

(c) *Adjusting accrual rates—(1) In general.* The rules in this paragraph (c) produce an adjusted accrual rate for each employee by determining the excess benefit percentage under the hypothetical plan formula that would yield the employer-provided accrual actually received by the employee, if the plan took into account the full permitted disparity under section 401(l)(3)(A) in

Internal Revenue Service, Treasury

§ 1.401(a)(4)-7

each of the first 35 years of an employee's testing service under the plan and used the employee's covered compensation as the integration level. This adjusted accrual rate is used to determine whether the amount of employer-provided benefits under the plan satisfies the alternative safe harbor for flat benefit plans under § 1.401(a)(4)-3(b)(4)(i)(C)(3) or the general test of § 1.401(a)(4)-3(c), and to apply the average benefit percentage test on the basis of benefits under § 1.410(b)-5. Paragraphs (c)(2) and (c)(3) of this section apply to employees whose average annual compensation does not exceed and does exceed, respectively, covered com-

pensation, and paragraph (c)(4) of this section provides definitions. Paragraph (c)(5) of this section provides a special rule for employees with negative unadjusted accrual rates.

(2) *Employees whose average annual compensation does not exceed covered compensation.* If an employee's average annual compensation does not exceed the employee's covered compensation, the employee's adjusted accrual rate is the lesser of the A rate and the B rate determined under the formulas below, where the permitted disparity factor and the unadjusted accrual rate are determined under paragraph (c)(4)(iii) and (v) of this section, respectively.

A Rate = $2 \times$ unadjusted accrual rate

B Rate = unadjusted accrual rate + permitted disparity factor

(3) *Employees whose average annual compensation exceeds covered compensation.* If an employee's average annual compensation exceeds the employee's covered compensation, the employee's adjusted accrual rate is the lesser of

the C rate and D rate determined under the formulas below, where the employer-provided accrual and the permitted disparity factor are determined under paragraph (c)(4)(ii) and (iii) of this section, respectively.

C Rate =
$$\frac{\text{employer-provided accrual}}{\text{average annual compensation} - \frac{1}{2} \text{ covered compensation}}$$

D Rate =
$$\frac{\text{employer-provided accrual} + (\text{permitted disparity factor} \times \text{covered compensation})}{\text{average annual compensation}}$$

(4) *Definitions.* For purposes of this paragraph (c), the following definitions apply.

(i) *Covered compensation.* Covered compensation means covered compensation as defined in § 1.401(l)-1(c)(7). Notwithstanding § 1.401(l)-1(c)(7)(iii), an employee's covered compensation must be automatically adjusted each plan year for purposes of applying this paragraph (c).

(ii) *Employer-provided accrual.* Employer-provided accrual means the amount determined by multiplying the employee's average annual compensation by the employee's unadjusted accrual rate.

(iii) *Permitted disparity factor—(A) General rule.* Permitted disparity factor for an employee means the sum of the employee's annual permitted disparity factors determined under paragraph (c)(4)(iii)(B) of this section for each of the years in the measurement period used for determining the employee's accrual rate in § 1.401(a)(4)-3(d)(1), divided by the employee's testing service during that measurement period.

(B) *Annual permitted disparity factor—(1) Definition.* An employee's annual permitted disparity factor is generally 0.75 percent adjusted, pursuant to § 1.401(l)-3(e), using as the age at which benefits commence the lesser of age 65